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NATIONAL COMMITTEE FOR MACROPRUDENTIAL OVERSIGHT

NCMO Recommendation No R/6/2017

on setting up a working group on the firms' financial soundness

Having regard to:

Identifying structural vulnerabilities concerning the financial soundness of non-financial corporations in Romania, which entail notable negative consequences on the stability of the Romanianfinancial system, i.e. persistence of negative financial results of many firms, poor quality of capital and the large number of firms either with owners' equity below the regulatory threshold or inactive, with an impact on (i) companies' balance sheets becoming frail, (ii) limiting access to financing, (iii) increasing the difficulties in the repayment of debts to trade partners, general government and banks, (iv) altering competition, the manner of resource allocation, the contribution to value added economy-wide, government budget receipts, and (v) distorting financial discipline,

Whereas:

The analysis of the state of the companies doing business in Romania revealed that, although at aggregate level the economic results and the financial soundness of non-financial corporations have continued to improve in recent years, structural vulnerabilities persist, entailing notable negative consequences on the stability of the Romanian financial system, namely: (i) persistence of negative financial results in many firms, (ii) poor quality of capital, and (iii) the large number of firms either with owners' equity below the regulatory threshold or inactive. Thus, in 2015, a number of 276.4 thousand firms (44 percent of the companies active in Romania) recorded owners' equity lower than 50 percent of share capital, i.e. below the threshold set by Law No. 31/1990 on commercial companies. Out of these companies, most of them have negative equity, i.e. 268.5 thousand firms. At the same time, from among the companies recording negative owners'equity as at end-2015, a significant percentage witnessed such a state in three of the last five years (72 percent), and the persistence thereof is also illustrated by the fact that nearly one-half of the companies recording negative equity in 2015 were in this state in each of the last five years (47 percent).

It is deemed that such a business behaviourleads to (i) companies' balance sheets becoming frail, (ii) limiting access to financing, in particular from professional creditors, which contributes to maintaining one of the weakest financial intermediation levels in the EU, (iii) difficulties in the repayment of debts to trade partners, general government and banks, (iv) significant direct implications on competition, resource allocation, contribution to value added economy-wide, government budget receipts, and (v) distorting financial discipline. The vulnerabilities these firms pose to the economy are all the more important as the share of companies recording negative owners' equity grew markedly over the past years (from about 10 percent of total companies in 1994 to more than 42 percent in 2016). The channels whereby risks pass through are: (1) non-performing loans in the credit institutions' balance sheets; and (2) payment discipline relative to trade partners and insolvency proceedings.

The need to take measures to improve firms' financial soundness arises from the perspective of the important and growing role that companies with negative owners' equity play in the economy, specifically: (i) they hire 15.6 percent of corporate sector employees, (ii) they create 7.8 percent of corporate turnover, (iii) they owe 39 percent of total corporate debt (in December 2016), and (iv) they account for 3 percent of companies' total expenses on profit/income tax and 11 percent of companies' total expenses on social protection and insurance in December 2016.

Pursuant to:

- Art. 1 para. (2), Art. 2 para. (1), and Art. 3 of Law No. 12/2017 on macroprudential oversight of the national financial system,

Pursuant to:

- Art. 4 para. (1) let. a) and b) of Law No. 12/2017 on macroprudential oversight of the national financial system,

the National Committee for Macroprudential Oversight has issued this recommendation:

The Government, by the agency of the Ministry of Public Finance, and the National Bank of Romania are recommended to set up a working group that should make in-depth analyses of the firms' financial soundness, using the datato be made available to this working group by the Ministry of Public Finance via the National Agency for Fiscal Administration, while complying with the confidentiality rules. The new data to be examinedshould at least refer to the reports on the deliveries/suppliesand acquisitions of goods made within the national territory (Form394) and the reports on intra-Community deliveries/supplies and acquisitions(Form 390), for every firm for which there are full historical data sets. Following the analyses made by the said working group, solutions will be identified so that businesses' budget constraints become tight in both public and private sectors.

MUGUR ISĂRESCU

Chairman